Public Notice and Agenda
MTC Litigation Committee Meeting

Capitol Plaza Hotel
1717 SW Topeka Boulevard
Topeka, Kansas
August 14-15, 2006

Monday, August 14, 2006

I. Welcome and Introductions (1:00 – 1:15)

II. Public Comment Period (1:15 – 1:30)

III. Report of the Executive Director (1:30 – 2:00)

IV. Action of the U.S. Supreme Court since March, 2006 on State Taxation and Federalism – *see attached case list* (2:00 – 2:45)

V. Closed Session for Information and Training for State Tax Attorneys (3:00 – 5:00)

Tuesday, August 15, 2006

VI. Closed Session for Information and Training for State Tax Attorneys, Continued (8:00 – 4:45, with lunch break)

VII. New Business (4:45 – 5:00)

VIII. Adjourn (Tuesday, August 15, 5:00)

Additional information on this meeting and agenda may be secured from Shirley Sicilian, Multistate Tax Commission, 444 North Capitol Street, NW, Suite 425, Washington, D.C. 20001-1538, telephone: (785) 312-9779, ssicilian@mtc.gov.

Action of the U.S. Supreme Court since March, 2006
on State Taxation and Federalism

Decisions

DaimlerChrysler v. Cuno, S.Ct. No. 04-1704, and *Wilkins v. Cuno*, S.Ct. No. 04-1724 (547 U.S. ____, 5/15/06). http://caselaw.lp.findlaw.com/scripts/printer_friendly.pl?page=us/000/04-1704.html The Supreme Court ruled unanimously that the taxpayer plaintiffs did not have standing to challenge in federal court a state tax credit given to a certain company as an incentive to locate in a particular jurisdiction because the plaintiffs had not demonstrated a case or controversy – i.e., an injury fairly traceable to the defendants' unlawful conduct that would likely be redressed by the requested relief – that would give the federal courts jurisdiction to hear the matter. The Court first determined that its rationale for rejecting federal taxpayer standing applied to state taxpayers as well. The Court rejected the plaintiffs' claim that, by depleting the state treasury, the franchise tax credit increased the tax burden to be borne by them, finding that that alleged injury was conjectural or hypothetical, first because "it is unclear that tax breaks of the sort at issue here do in fact deplete the treasury," and, second, because there was no way of knowing how a legislature would respond to a reduction in revenue, if that is the consequence of such a credit. The Court then refused to accept the plaintiffs' theory of ancillary standing, under which the plaintiffs would have standing to challenge the state tax credit based on the municipal taxpayer standing that allowed them to challenge the local property tax benefit, on the basis that both challenges involved the same operative facts. The Court determined that such a holding would remove any restriction on judicial interference in political matters. The Court ruled: "Because plaintiffs have no standing to challenge [the franchise tax credit], the lower courts erred by considering their claims against it on the merits. The judgment of the Sixth Circuit is therefore vacated in part, and the cases remanded for dismissal of the plaintiffs' challenge to the franchise tax credit." One week later, the Court denied certiorari in the plaintiffs' appeal of the Sixth Circuit's decision upholding the constitutionality of the property tax exemption.

Lingle, Governor of Hawaii v. Arakaki, et al., 423 F.3d 954 (9th Cir., 8/31/05), S.Ct. No. 05-988 (6/12/06). Arakaki v. **Lingle,** 423 F.3d 954, 2005 U.S. App. LEXIS 18839 (9th Cir. Haw., 2005) (Lexis/Nexis Cite). The U.S. Supreme Court vacated 9th Circuit holding that a group of Hawaii taxpayers had standing, based on their taxpayer status alone, to challenge the state's expenditure of state tax revenue on programs benefiting indigenous Native Hawaiians, and remanded the case for further consideration in light of *DaimlerChrysler v. Cuno.* On the same day, the Supreme Court also denied a separate petition for certiorari involving the same case, which presented a request by the plaintiff-taxpayers for review of that part of the Ninth Circuit opinion dismissing related claims. *Arakaki, et al. v. Lingle, Governor of Hawaii, et al.*, 423 F.3d 954 (9th Cir., 8/31/05), S.Ct. No. 05-1128. (© 2006 CCH Tax Tracker News)

Certiorari Pending

ANR Pipeline Co. v. Louisiana Tax Commission, 923 So.2d 81 (La. Ct. App. 9/7/05), *cert. filed* S.Ct. No. 05-1606 (6/15/06). http://www.lasc.org/opinions/2003/02c1479.opn.pdf The Louisiana

Court of Appeal held that the state's property tax assessment methodology applied to certain taxpayer pipeline companies violated the Equal Protection and Due Process Clauses of the Louisiana and U.S. Constitutions. The state court determined that certain pipeline companies were unconstitutionally given preferred treatment when their pipelines were valued at depreciated replacement cost and assessed at 15% of fair market value, while the taxpayers' pipelines were valued as public service properties at 25% of fair market value. The state court held that the appropriate remedy for this systematic under-assessment of other pipelines was to employ the same valuation and assessment methodology as that used to assess the preferred properties to achieve uniformity and equality. (© 2006 RIA Checkpoint)

Bond v. California Franchise Tax Board, No. 05-55197 (9th Cir. 3/29/06, unpublished), *cert. filed* S.Ct. No. 05-1540 (5/31/06). Here, the Ninth Circuit Court of Appeals affirmed the dismissal of a taxpayer's challenge of the California Franchise Tax Board's assessment of personal income tax, for lack of jurisdiction under the federal Tax Injunction Act. The courts also dismissed claims on the bases that the FTB is not a "person" under 42 U.S.C. §§1983 or 1985, and that the state is entitled to Eleventh Amendment immunity.

Schulz v. Washington County Board of Supervisors (2nd Cir. 8/15/04, unpublished), *cert. filed* S.Ct. No. 05-1331 (4/14/06). Individuals who withheld property tax payments to two New York counties as a protest have asked the U.S. Supreme Court for review of a decision dismissing their federal action pursuant to the federal Tax Injunction Act (TIA). The individuals placed their property tax payments in trust to protest what they asserted was the unconstitutional enactment of a bill financing a waste facility. They then filed suit in federal court alleging that the actions taken by the counties against them for failure to pay their taxes were in retaliation for the exercise of their constitutional rights to express their opinion. The U.S. District Court for the Northern District of New York held that the state tribunals offered an appropriate remedy and, therefore, the action in federal court was barred by the TIA. The U.S. Court of Appeals for the Second Circuit affirmed. The individuals have asked the high court whether the TIA can trump the Petition Clause of the First Amendment of the U.S. Constitution. (© 2006, CCH Tax Tracker News)

McLane Western, Inc. v. Dept. of Revenue, No. 03CA2471 (Colo. Ct. App. 5/5/05), *cert. filed* S.Ct. No. 05-1294 (4/7/06). http://www.courts.state.co.us/coa/opinion/2005/2005q2/03CA2471.pdf
Colorado imposes an excise tax on the sale of tobacco products other than cigarettes, at a rate of twenty percent of the manufacturer's list price, which is defined as the invoice price for which a manufacturer or supplier sells a tobacco product to a distributor. The tax is imposed at the time the distributor brings the product into the state, ships it to retailers in the state, or manufactures it for sale in the state. A distributor asserted that, because each layer in the distribution network marks up the price, the tax imposed will be higher the later in the distribution network that the taxable event occurs, so that the tax base would be at its lowest if the manufacturer and all the distributors were located in Colorado, and this produces pressure on out-of-state businesses to move into the state, in violation of the Commerce Clause as discrimination against interstate commerce. The Colorado Court of Appeal ruled that the tax did not violate the Commerce Clause, finding that there was no facial discrimination or discrimination in effect, as all taxable

distributors were taxed at the same rate and on a tax base determined in the same fashion. The court also rejected the distributor's assertion that the definition of "manufacturer's list price" requires that the price upon which the tax is based should be the price paid by the entity from which the distributor purchased the products, finding that the taxable price is the one the distributor paid.

Certiorari Denied

American Trucking Associations, Inc., et al. v. Oregon, et al., 124 P.3d 1210 (Ore. 12/15/05), *cert. denied*, S.Ct. No. 05-1177 (6/26/06). http://www.publications.ojd.state.or.us/S51622.htm While the primary method Oregon uses to tax heavy trucks that use its highways is a weight-mile tax, the state also allows a flat-fee option for carriers of certain commodities, and an exemption for farm vehicles. In 2004, the Court of Appeals of Oregon ruled that the flat-fee option violated the Commerce Clause, because, despite that it was optional, it favored intrastate carriers over interstate carriers and violated the principle of internal consistency, on the basis that any hypothetical situation involving an unapportioned flat-fee option produced a "malapportionment and discriminatory effect as to interstate carriers that exceed the presumed average mileage [upon which the flat fee is calculated]." The Supreme Court of Oregon reversed that decision. After finding that the correct test for determining the validity of the flat-fee option was the four-part test of Complete Auto Transit, the court first determined that the flat-fee option was internally consistent, because the fee is imposed on an activity that took place entirely within the state's borders, so that, if all states imposed the same fee, interstate commerce would not be subject to multiple taxation. The court then determined that, as to the question of whether the flat-fee option discriminated against interstate commerce, the flat-fee option was not facially discriminatory, and the plaintiffs had failed to present any evidence of actual discrimination against interstate commerce. The court relied on the U.S. Supreme Court's recent decision in a similar case, American Trucking Associations, Inc., et al. v. Michigan Public Service Commission, et al., for the point that plaintiffs cannot rely on hypothetical assertions to establish the existence of discriminatory economic effects, but rather, plaintiffs must demonstrate actual discrimination.

U.S. Steel Mining Co., LLC, et al. v. Helton, No. 32528 (W.Va. 12/2/05), *cert. denied* S.Ct. No. 05-1268 (6/5/06). http://www.state.wv.us/wvsca/Docs/Fall05/32528.pdf The Supreme Court of Appeals of West Virginia ruled that West Virginia's coal severance tax does not violate the Import-Export Clause of the federal constitution, which prohibits states from imposing "any Impost or Duties on Imports or Exports." The court determined that, under standards established by U.S. Supreme Court decisions, the severance tax did not affect the federal government's ability to speak with one voice on matters of commercial relations with foreign governments, because a mere increase in the price of coal that might result from the tax was neither the kind of adverse effect on foreign relations nor a violation of a clear federal directive envisioned by those decisions. The court also rejected the taxpayers' argument that the inclusion in the tax calculation of the cost of loading the coal into rail cars at the preparation plant under an "F.O.B. Mine" method indicated that the tax was imposed on the coal while it was in the export transit process, in violation of an earlier U.S. Supreme Court ruling.

INOVA, Inc. v. Strayhorn, 166 S.W.3d 394 (Tex. Ct. App., 5/26/05), *cert. denied* S.Ct. No. 05-1130 (4/17/06).
http://www.lexis.com/research/retrieve/frames?_m=1fd945930da792a587fa2b9808b10894&csvc=bl&cform=bool&_fmtstr=XCITE&docnum=1&_startdoc=1&wchp=dGLbVtb-zSkAA&_md5=bb9db0c3aa236a394e339ce4ebe69707 (Lexis/Nexis cite) The Texas corporate franchise tax is assessed on the corporation's taxable earned surplus or its taxable capital, whichever is higher under a statutory formula. A California corporation that manufactured products used in medical testing was first assessed with the tax when it hired an employee in the state, and the taxpayer asserted that, because the statutory formula is stated in terms that require a calculation of both capital and surplus, the taxpayer was protected from the tax by the federal Public Law 86-272, which prohibits states from imposing an income tax on a corporation whose only activity in the state is the solicitation of sales; the taxpayer also asserted that it lacked a substantial nexus with the state. The Texas Court of Appeals upheld the imposition of the tax. The court first determined that, while the franchise tax is one integrated tax, what is included in the calculation is "taxable earned surplus," and a comptroller's rule acknowledges that an out-of-state corporation that only solicits orders in the state would have no taxable earned surplus, so that such a corporation's franchise tax would be based solely on net taxable capital. The court then rejected the taxpayer's assertion that the net income is an integral part of the taxable capital component of the franchise tax, finding that the extension of the exemption of P.L. 86-272 to taxes that only use net income as a factor in calculating another tax would be inconsistent with the legislative history of the act, as well as decisions of the other state courts that have considered the issue. Finally, the court ruled that, under the physical-presence requirement of Quill, which this court had previously determined to be the applicable nexus standard for the franchise tax, the taxpayer's permanent sales presence in the state provided a substantial nexus, so that the imposition of the tax did not violate the Commerce Clause.